ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Bogh	Analyst:	Jane Tolman	Bill Number:	AB 2168
Related Bills:	See Legislative History	Telephone:	845-6111	Introduced Date:	02-20-2002
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Exclusion/$10,000 Of Retirement Income And Benefits

SUMMARY

This bill would exclude up to $10,000 of retirement income from taxation.

PURPOSE OF THE BILL

It appears that the purpose of this bill is to assist low-income senior citizens.

EFFECTIVE/OPERATIVE DATE

This bill would take effect immediately as a tax levy and apply to taxable years beginning on or after January 1, 2002.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the concerns noted in this analysis.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Federal law generally taxes pensions, Individual Retirement Accounts (IRA's) (other than Roth IRA), annuity plans, tier 2 railroad retirement, and self-employed retirement plan benefits. Social Security and the equivalent tier 1 railroad retirement benefits can be partially taxable depending on the taxpayer's total income. Essentially, the higher the total taxable income, the greater the taxable part of the Social Security or equivalent tier 1 railroad retirement benefits.

California generally conforms to the federal law regarding the taxing of pensions, IRAs, annuities, and retirement income. However, California excludes from taxation any Social Security, tier 1, or tier 2 railroad retirement benefits.

Board Position:			Department Director	Date
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______ N	______ OUA	__X__ PENDING		

Federal law prohibits states from taxing the pensions of nonresidents. California law conforms to the federal law, with a detailed description of what qualifies as retirement and pension income. A nonresident is still taxed on other California source income.

THIS BILL

This bill would expressly exclude from gross income up to $10,000 of retirement income and benefits received by qualified individuals.

An individual would qualify for the exclusion depending on his/her filing status and total income. A taxpayer using the single filing status or a taxpayer using the married filing separate status must have total income of $50,000 or less to qualify for the exclusion. Taxpayers using the married filing joint, head of household, or surviving spouse filing statuses must have total income of $100,000 or less.

IMPLEMENTATION CONSIDERATIONS

The taxpayer's "total income" would be used to determine if the taxpayer qualifies for the exclusion in this bill. California tax law does not use a figure referred to as total income. It would be helpful if the bill was amended to use either adjusted gross income or taxable income, as these amounts are already defined in tax law, established on the department's systems, and provided on the tax forms. Using already established terms would make this bill easier for the department to implement and taxpayers to understand.

This bill does not define the term "retirement income or retirement benefits." The absence of a definition to clarify this term could lead to confusion for the taxpayer and would complicate the administration of this credit.

LEGISLATIVE HISTORY

AB 1887 (Hollingsworth, 2001/2002) would exclude from taxation Social Security retirement income and benefits, and annuity retirement income from federal civil service. This bill is currently in the Assembly Revenue and Taxation Committee.

AB 1365 (Oller, 1999/2000) would have excluded from California gross income any military retirement pay, military disability pay, or any other benefits received from the armed forces by a person retired from the armed forces. This bill failed in the Assembly Revenue and Taxation Committee.

AB 2561 (Zettel, 1999/2000) would have excluded from California gross income any military retired pay and any survivor annuities received as a result of active service as a member of the armed forces. This bill failed in the Assembly Revenue and Taxation Committee.

AB 2661 (Connolly, 1993/94) would have excluded from California gross income any military retirement pay, military retainer pay or military survivor's annuity received by a nonresident. This bill failed in the Assembly Ways and Means Committee.

OTHER STATES' INFORMATION

A review of the tax laws of *Illinois, Massachusetts, Minnesota, Michigan*, and *New York* found that they treat retirement income and benefits in the same manner as California. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

Once the implementation concerns are resolved, this bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill is estimated to impact revenue as shown in the following table.

AB 2168 As Introduced February 20, 2002 Fiscal Year Cash Flow Tax Years Beginning After December 31, 2001 Enactment Assumed After June 30, 2002 ($ Millions)			
Fiscal Year	2002-03	2003-04	2004-05
	-$590	-$420	-$415

(Estimates are rounded to the nearest $5 million.)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

It is estimated that over one million filers would benefit from this proposal for tax year 2002.

The revenue estimates above were initially calculated on a tax year liability basis and then converted to fiscal year, cash-flow projections (July 1 – June 30). The latter estimates take into account the timing of changes to withholding and estimated taxes paid throughout the year by taxpayers affected by the bill as well as changes to year-end tax payments and refunds.

Revenue Discussion

Revenue losses were estimated by the use of the department's personal income tax model to simulate the exclusion of pension income. Data for the tax model were based on the federal individual tax return, line 16a, Total Pensions and Annuities, for California filers.

For this analysis, the retirement income exclusion was limited to $10,000 for single and married filing separate, and $20,000 for married filing joint, head of household, and surviving spouse. Income limits are not indexed. Regarding the total income test of $50,000 and $100,000, the measurement used was adjusted gross income as reported on the state tax returns.

ARGUMENTS/POLICY CONCERNS

This bill would allow the exclusion of up to $10,000 of retirement income to all taxpayers regardless of filing status. Generally, tax benefits are a set amount for taxpayers using the single and married filing separate filing status, and double the amount for head of household, surviving spouse, or married filing joint. Under this bill, a taxpayer using the single filing status would receive the same exclusion as taxpayers using the married filing joint filing status, which is contradictory to general tax policy.

Also, many tax benefits are indexed annually for inflation. This bill does not contain this language, so the exclusion would be less beneficial as time progresses.

LEGISLATIVE STAFF CONTACT

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